No. 15752

In the United States Court of Appeals for the Ninth Circuit

MATHEW J. SPIESMAN, JR., and MARY SPIESMAN,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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CITATIONS

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 161-186) are reported at 28 T.C. 567.

JURISDICTION

The Commissioner determined that there were deficiencies in the income taxes of Mathew J. Spiesman, Jr., and Mary Spiesman for the years 1951 and 1952 as follows (R. 161):

Year	Deficiency	Additions to Tax [1]
1951	$ 2,155.22	$356.93
1952	14,056.20	986.14

A notice of such deficiencies was mailed on November 18, 1954. (R. 16-24.) Taxpayers filed a petition for redetermination of these deficiencies in the Tax Court on January 28, 1955, within the permitted 90-day period under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3, 5-16.) On June 7, 1957, the Tax Court entered a decision that there were deficiencies in income tax in the amounts of $2,155.22 and $14,056.20 for the years 1951 and 1952, respectively. (R. 186.) On August 29, 1957, the Tax Court entered an order amending its decision providing that there were no additions to tax for the years involved. (R. 187.) The case is brought to this Court by a petition for review filed on August 30, 1957. (R. 188-192.) The jurisdiction of this Court is invoked under the provisions of Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court correctly held that the taxpayers' five minor children were not the real owners of capital interests in the taxpayers' business and were not bona fide partners in the Spiesman & Sons partnership during the years 1951 and 1952.

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[1] No issue is presented in this appeal concerning the additions to tax. The Commissioner abandoned his determination that taxpayers were liable for such additions during the proceedings in the Tax Court. (See R. 185.)

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 191 [As added by Sec. 340(b) of the Revenue Act of 1951, c. 521, 65 Stat. 452]. FAMILY PARTNERSHIPS.

In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service. For the purpose of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trust for the primary benefit of such persons.

(26 U.S.C. 1952 ed., Sec. 191.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

*   *   *   *

(2) [as amended by Sec 340(a) of the Revenue Act of 1951, *supra*] *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization. A person shall be recognized as a partner for income purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

* * * *

(26 U.S.C. 1952 ed., Sec. 3797.)

STATEMENT

The facts as found by the Tax Court (R. 162-174) may be summarized as follows:

Taxpayers Mathew J. Spiesman, Jr. and Mary Spiesman, are husband and wife residing at St. Maries, Idaho. They filed a joint federal income tax return for the calendar year 1951 with the then Collector of Internal Revenue for the District of Idaho, and for the calendar year 1952, with the District Director of Internal Revenue, Boise, Idaho. (R. 162.)

Prior to 1950, taxpayer Mathew J. Spiesman, Jr.

(hereinafter sometimes referred to as Spiesman or as the taxpayer), was the owner of certain gambling devices commonly known as slot machines. These machines were operated in a bar known as the Gem State Club under an agreement between Spiesman and the Club, whereby Spiesman received 20 per cent of the receipts from the slot machines. Spiesman was president and manager of the Gem State Club, a corporation. In 1947 the legislature for the State of Idaho enacted a statute (S.L. 1947, c. 151; Sections 50-1501 to 1510, inclusive, Idaho Code), which was subsequently declared unconstitutional and repealed, providing that it should be lawful for any person to own and operate coin-operated amusement devices within the corporate limits of any incorporated city or village, after having first procured a license as therein provided. The term "person" was defined to include "an individual person, partnership, corporation or association". (R. 162-163.)

On February 1, 1950, Spiesman, Jr., and his father, Mathew J. Spiesman, Sr., entered into a partnership agreement for the purpose of carrying on the business of operating and maintaining coin-operated amusement devices. The agreement recited that "the assets to be taken over by the partnership are in the possession and owned by the partner, M. J. Spiesman, Jr." It further recited that "M. J. Spiesman, Sr., agrees to pay a sum equal to one-half the value of the assets;" that they should bear "equally between them all licenses, fees, permits and other expenses" required for the support and management of the business; and that profits from the business

should be divided, one-third to Spiesman, Sr., and two-thirds to Spiesman, Jr. (R. 163-164.)

Spiesman, Sr., now 80 years of age, had for several years been distributing part of his estate by making gifts of real estate, stocks and mortgages to Spiesman, Jr., and to the latter's five sons, whose names and date of birth are as follows (R. 164):

Name	Date of Birth
Michael Joseph	October 21, 1940
Philip James	November 29, 1943
Leonard John	February 11, 1945
Mathew James III	July 3, 1946
Francis Edward	September 26, 1950

On December 1, 1951, a new partnership agreement was entered into between Spiesman, Sr., and Spiesman, Jr., individually and on behalf of his five minor sons (R. 164), which is in part as follows (R. 164-170):

Partnership Agreement

> This Agreement of Partnership, made in duplicate as of the first day of December, 1951, by and between Mathew James Spiesman, Sr., Mathew James Spiesman, Jr., Michael James [Joseph] Spiesman, Mathew James Spiesman, III, Philip James Spiesman, Leonard John Spiesman, and Francis Edward Spiesman, all of St. Maries, Benewah County, Idaho,
>
> Witnesseth, that the said parties have agreed and by these presents do agree to associate themselves as partners for the purpose of carrying on the business of operation and maintenance of coin-operated amusement devices, and incidental concessions connected therewith, to the

faithful performance of which they mutually bind and engage themselves, each to the other, their executors and administrators.

First: The name, style and title of such partnership shall be Spiesman & Sons,

Second: At the time of this agreement, the assets to be taken over by the partnership are in possession and owned by the partner[s], Mathew James Spiesman, Jr., [and Mathew J. Spiesman, Sr.] and are in the value of $2,374.63. The capital of said partnership in addition to the aforementioned assets shall consist of cash contributions divided into nine equal shares, of which each of the partners shall own one-ninth, with the exception of the partner, Mathew James Spiesman, Jr., who shall own one-third of the shares. Further cash contributions shall consist of:

Michael James Spiesman	$100.00
Mathew James Spiesman, III	100.00
Philip James Spiesman	100.00
Leonard John Spiesman	100.00
Francis Edward Spiesman	100.00

The capital of the partnership in addition to the initial cash contributions enumerated above shall also consist of the income and profits arising from the employment thereof, with the exception of that which each is entitled to withdraw as hereinafter provided. That said capital may at any time be reduced or extended by agreement between the parties hereto, and that the said capital, together with all credits, goods, wares or commodities bought or obtained by the said firm, by barter or otherwise, shall be kept, used and employed in and about the business aforesaid.

Third: The term for which this partnership is organized is for an indefinite period from and after December 1, 1951.

Fourth: Duties of Partners. The partner, Mathew James Spiesman, Jr., shall be actively in charge of the business and shall assume the functions customarily performed and shall perform the duties as manager. He shall devote a major portion of his time, attention, experience and endeavors to said business. The partners, Mathew James Spiesman, Sr., Michael James Spiesman, Mathew James Spiesman, III, Philip James Spiesman, Leonard John Spiesman and Francis Edward Spiesman, shall and will at all times during the continuance of the partnership bear, pay and discharge equally with all partners all the licenses, fees, permits and other expenses that may be required for the support and maintenance of said business.

*   *   *   *

Seventh: Share in Profits. Periodically, at either monthly or quarterly intervals, each partner shall be entitled to withdraw from the business as a salary an amount of income commensurate with the capital stock owned by them and the services which they have contributed; however, under no circumstances shall said withdrawals impair the operating capital of the partnership. No further withdrawals shall be made in the form of profit after payment of salaries to the partners until such time as all indebtedness owing by the partnership has been paid.

In addition to the above-mentioned share in the profits, the partner, Mathew James Spiesman, Jr., shall draw as salary for managing the

partnership business the sum of Two Hundred Fifty ($250) Dollars per month.

*   *   *   *

In Witness Whereof, the parties hereto have hereunto set their hands and seals the day and year in this partnership agreement first above written.

/s/ Mathew James Spiesman,
/s/ Mathew James Spiesman, Jr.,
/s/ Michael Joseph Spiesman,
/s/ Mathew James Spiesman, III,
/s/ Philip James Spiesman,
/s/ Leonard John Spiesman,
/s/ Francis Edw. Spiesman,

By /s/ M. J. Spiesman, Jr.,

Guardian for Michael James Spiesman, Mathew James Spiesman, III, Philip James Spiesman, Leonard John Spiesman, Francis Edward Spiesman.

The interlineations appearing in paragraph numbered "Second" were inserted by Spiesman, Jr., in 1953, after the initiation of the investigation of taxpayers' income tax returns for the year involved. The $100 cash contributions on behalf of each of the minor children were made by their father either from funds belonging to them or advanced by him. (R. 170.)

A partnership return (Form 1065) was filed by Spiesman & Sons for the period beginning December 1, 1951, and ending January 1, 1952, showing

net earnings in the amount of $3,254.30, distributable as follows (R. 170):

Mathew J. Spiesman, I	$ 361.59
Mathew J. Spiesman, II	1,084.76
Mathew J. Spiesman, III	361.59
Philip Spiesman	361.59
Michael Joe Spiesman	361.59
Francis Spiesman	361.59
Leonard Spiesman	361.59

No withdrawals for this period were shown and the capital accounts at the beginning of the period and at the end of the period were shown as follows (R. 171):

	Beginning of Period	End of Period
Mathew J. Spiesman, I	$ 100.00	$ 461.59
Mathew J. Spiesman, II	2,774.63	3,859.39
Mathew J. Spiesman, III	100.00	461.59
Philip Spiesman	100.00	461.59
Michael Joe Spiesman	100.00	461.59
Francis Spiesman	100.00	461.59
Leonard Spiesman	100.00	461.59

A partnership return (Form 1065) was filed by Spiesman & Sons for the year 1952 showing net earnings in the amount of $46,021.71, distributable as follows (R. 171):

Mathew J. Spiesman, I	$ 4,846.85
Mathew J. Spiesman, II	16,940.61
Mathew J. Spiesman, III	4,846.85
Philip Spiesman	4,846.85
Michael Joe Spiesman	4,846.85
Francis Spiesman	4,846.85
Leonard Spiesman	4,846.85

The capital accounts of each of the above-named partners at the beginning of the year 1952, with-

drawals during that year and the capital accounts at the end of the year were shown as follows (R. 172-172):

	Capital Account at Beginning of Year	Withdrawals	Capital Account at End of Year
Mathew J. Spiesman, I	$ 461.59	$ 3,688.83	$1,619.61
Mathew J. Spiesman, II	3,859.39	16,768.68	4,031.32
Mathew J. Spiesman, III	461.59	4,690.16	618.28
Philip Spiesman	461.59	2,592.80	2,715.64
Michael Joe Spiesman	461.59	2,593.25	2,715.19
Francis Spiesman	461.59	3,448.01	1,860.43
Leonard Spiesman	461.59	4,950.96	357.48

The income shown on the partnership returns was derived from the operation of the slot machines and other coin-operated amusement devices, most of which were located in the Gem State Club and continued to be operated under the original agreement as to percentages entered into between Spiesman and the Club prior to the formation of the partnerships between Spiesman and his father, and Spiesman & Sons. All licenses for the operation of the machines were obtained and paid for by the Gem State Club or other locations where they were placed. Spiesman spent about 3½ hours each day in the management of Spiesman & Sons' affairs. He was also manager of the Gem State Club, for which he received a salary of $6,000 in 1951 and $7,500 in 1952, and spent six to seven hours each day in its management. Capital is a material income-producing factor of the Spiesman & Sons partnership. The salary paid Spiesman for managing the affairs of the partnership is reasonable. (R. 172.)

Spiesman had been appointed guardian of the estates of his four minor sons, Michael Joseph, Philip James, Leonard John, and Mathew James, III, by the Probate Court of Benewah County, Idaho, on April 17, 1947. He was appointed guardian of the estate of Francis Edward by the same court on October 13, 1953. (R. 172-173.)

No opening or annual inventory and accounting reports of the estates of any of the minor children, as required by Sections 15-1825 and 15-1826 of the Idaho Code (1948), were filed by Spiesman as guardian during any of the years 1947 to 1952, inclusive; nor was there any supervision of the guardianship accounts otherwise exercised by the probate court during that period. On October 23, 1953, after the initiation of the investigation of taxpayers' income tax returns for the years involved, Spiesman as guardian filed annual inventory and accounting reports of the estates of four of his sons, Mathew James, III, Philip James, Michael Joseph and Leonard John, for each of the years 1947 to 1952, inclusive. These reports were approved, allowed and settled by order of the Probate Court dated November 12, 1953. As he had not, prior to October 13, 1953, been appointed guardian of Francis Edward, no inventory or accounting report of the estate of Francis Edward was filed at that time. Annual inventory and accounting reports of the estates of all five of the children for the years 1953, 1954, and 1955 were filed in 1954, 1955, and 1956, respectively. (R. 173.)

Withdrawals from the Spiesman & Sons partnership on behalf of each of the five minor children,

during the year 1952, were made by Spiesman. (R. 173.) According to the inventory and accounting reports filed by Spiesman as guardian of the estates of his minor children, the following amounts were withdrawn from Spiesman & Sons on their behalf, respectively, during the years 1952 to 1955, inclusive (173-174):

	1952	1953	1954	1955
Mathew James	$5,690.16	$3,124.20	$ 270.73	None
Philip James	1,592.80	3,557.13	2,005.33	None
Michael Joseph	1,593.25	3,626.12	1,936.62	None
Francis Edward	(not shown)	3,079.35	291.94	None
Leonard John	3,848.01	3,500.16	269.85	None

Separate savings accounts for each of the minor children were opened in the Farmers & Merchants Bank of Rockford, Rockford, Washington, on March 17, 1952. Some of the funds withdrawn from the partnership on behalf of the children were deposited in their respective savings accounts; some were used to pay premiums on their individual life insurance policies; some were used to pay their income taxes; and occasionally some were used to purchase additional securities for them. None of these funds, insofar as the accounting reports filed with the Probate Court reveal, were used for the support or living expenses of any of the minor children. (R. 174.)

On their income tax return for 1952, taxpayers reported the sum of $17,077.25 as partnership income, of which $16,940.61 was received from Spiesman & Sons, and $136.64 from Spiesman and Resor. (R. 174.)

The Tax Court in a unanimous opinion held that

the five minor children of taxpayers were not the owners of capital interests in the business and were not bona fide partners in the Spiesman & Sons partnership during the years 1951 and 1952. (R. 174.)

SUMMARY OF ARGUMENT

1. The Tax Court correctly held that the taxpayer's children were not the real owners of capital interests in the taxpayer's business and were not bona fide partners with him during the years 1951 and 1952. The amendments to the Internal Revenue Code of 1939, insofar as they affected the law relating to the tax consequences of family partnerships, were intended to change the existing law in only one respect. Congress, in the Revenue Act of 1951 attempted to make it plain that a family partnership should not be denied recognition for tax purposes merely because some of the partners received capital interests in the partnership by gift. The intent of Congress is clear, however, that such intra-family arrangements should be carefully examined to see whether bona fide gifts were, in fact, made and whether the purported partnership was merely a sham. Congress did not intend that every purported family partnership should be recognized for tax purposes, merely because such a partnership is claimed to exist. Its only purpose in the 1951 amendments was to eliminate some existing confusion as to whether a valid partnership *could* be created by a true gift.

2. The Tax Court correctly applied the 1951 amendments to the facts in the instant case. The Tax Court did not hold that a valid partnership was

not created because the claimed capital interests of the taxpayer's minor children came into being through gifts. On the contrary, the Tax Court recognized that a valid partnership could be created by true gifts of capital interests, but found, on the record in the instant case, that no bona fide gifts were intended or made and that the purported partnership was a sham.

3. These factual determinations of the Tax Court are fully supported by the record in the case at bar and, accordingly, should not be disturbed on appeal. Several factors in the record point to the conclusion that no bona fide gifts were made and that the purported partnership was a mere sham devised for tax purposes. For example, the agreement which allegedly created the claimed partnership was not carried out in the extremely important matter of distribution of business profits. Distributions were not made to taxpayer's children in proportion to the capital interests which it is claimed they owned; instead, distributions were made by the taxpayer to equalize family gifts to the children. In addition, the failure of the taxpayer to file any guardianship accounts until after the tax investigation was begun also points to a lack of bona fides. Moreover, the taxpayer's children could not, under Idaho law, legally have owned interests in the slot machine which were the partnership assets. These and other facts affirm the correctness of the Tax Court's conclusion that no true gifts of business assets were made to the taxpayer's children, that the children were not true partners in the business, and that no partnership, valid

for tax purposes, was in existence during the years 1951 and 1952. Accordingly, the decision of the Tax Court should be affirmed.

ARGUMENT

The Tax Court Correctly Held That the Taxpayer's Children Were Not the Real Owners of Capital Interests In the Taxpayer's Business and Were Not Bona Fide Partners With Him During the Years 1951 and 1952

This case involves the validity of a so-called family partnership for the years 1951 [2] and 1952. The Commissioner of Internal Revenue determined that the minor children of taxpayer Mathew J. Spiesman, Jr.,[3] were not partners in the partnership called Spiesman & Sons within the meaning of Sections 191 and 3797 (a)(2) of the Internal Revenue Code of 1939, *supra*. The Tax Court, in an opinion reviewed by the entire court, without dissent upheld the Commissioner's determination. The taxpayer has appealed from the Tax Court's decision contending mainly that the Tax Court's construction of Sections 191 and 3797 (a)(2), as amended by Section 340 of the Revenue Act of 1951, was improper and that the evidence in the case does not support the Tax Court's findings. We submit, on the contrary, that the Tax Court's decision is in all respects correct and should be affirmed.

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[2] The alleged partnership was in existence for only one month during the year 1951. (R. 170.)

[3] Mary Spiesman is the wife of Mathew, Jr., and is a party because she and her husband filed joint income tax returns for the years involved. (R. 162.)

1. Prior to the Revenue Act of 1951, there existed some confusion as to whether a partnership valid for tax purposes could be created as the result of a transfer by gift of an interest in the business which became the subject of the partnership. The test for determining whether a valid partnership for tax purposes was in existence was laid down by the Supreme Court in *Commissioner* v. *Culbertson*, 337 U. S. 733. The question to be decided in such cases, according to the Supreme Court (p. 742), was one of fact and depended on "whether, considering all the facts * * * the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise". The Tax Court had been treating as essential to membership in a valid family partnership a contribution of either vital services or original capital. The Supreme Court pointed out (p. 741) that the Tax Court approach in such cases was "at best, an error in emphasis" and took pains to add (p. 745) that in an earlier decision (*Commissioner* v. *Tower*, 327 U.S. 280) it "did *not* say that the donee of an intra-family gift could *never* become a partner through investment of the capital in the family partnership" (italics supplied). The Supreme Court in *Culbertson* further pointed out (p. 746) that the "existence of a family relationship * * * is simply a warning that things may not be what they seem" and accordingly that "transactions between members of a family will be carefully scrutinized" to determine whether a donee of property who purportedly invests that property in a family partnership acquires sufficient dominion and

control over that property to influence the conduct of the partnership and the disposition of its income and thus becomes (p. 747) "a true partner".

Notwithstanding the Supreme Court's decision in the *Culbertson* case, there apparently still remained some confusion as to the creation of a family partnership through the use of gift capital. Therefore, in the Revenue Act of 1951, Congress added to the 1939 Code Section 191 which provides that—

> In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. * * *

Congress at the same time also added to Section 3797 (a)(2) of the 1939 Code, which defines the words "partnership" and "partner", a sentence providing—

> A person shall be recognized as a partner for income purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

The intent of the Congress in adding these provisions to the Code is plainly expressed in the Report of the Committee on Ways and Means of the House

of Representatives. This Report, in part, is as follows (H. Rep. No. 586, 82d Cong., 1st Sess, pp. 32-34 (1951-2 Cum. Bull. 357, 380-381)):

> Section 312 of your committee's bill is intended to harmonize the rules governing interests in the so-called family partnership with those generally applicable to other forms of property or business. Two principles governing attribution of income have long been accepted as basic: (1) income from property is attributable to the owner of the property; (2) income from personal services is attributable to the person rendering the services. There is no reason for applying different principles to partnership income. If an individual makes a bona fide gift of real estate, or of a share of corporate stock, the rent or dividend income is taxable to the donee. Your committee's amendment makes it clear that, however the owner of a partnership interest may have acquired such interest, the income is taxable to the owner, if he is the real owner. If the ownership is real, it does not matter what motivated the transfer to him or whether the business benefited from the entrance of the new partner.
>
> Although there is no basis under existing statutes for any different treatment of partnership interests, some decisions in this field have ignored the principle that income from property is to be taxed to the owner of the property. Many court decisions since the decision of the Supreme Court in *Commissioner* v. *Culbertson* (337 U. S. 733) have held invalid for tax purposes family partnerships which arose by virtue of a gift of a partnership interest from one member of a family to another, where the donee performed

no vital services for the partnership. Some of these cases apparently proceed upon the theory that a partnership cannot be valid for tax purposes unless the intrafamily gift of capital is motivated by a desire to benefit the partnership business. Others seem to assume that a gift of a partnership interest is not complete because the donor contemplates the continued participation in the business of the donated capital. However, the frequency with which the Tax Court, since the Culbertson decision, has held invalid family partnerships based upon donations of capital, would seem to indicate that, although the opinions often refer to "intention," "business purpose," "reality," and "control," they have in practical effect reached results which suggest that an intrafamily gift of a partnership interest, where the donee performs no substantial services, will not usually be the basis of a valid partnership for tax purposes. * * *

The amendment leaves the Commissioner and the courts free to inquire in any case whether the donee or purchaser actually owns the interest in the partnership which the transferor purports to have given or sold him. Cases will arise where the gift or sale is a mere sham. Other cases will arise where the transferor retains so many of the incidents of ownership that he will continue to be recognized as a substantial owner of the interest which he purports to have given away, as was held by the Supreme Court in an analogous trust situation involved in the case of *Helvering* v. *Clifford* (309 U.S. 351). The same standards apply in determining the bona fides of alleged family partnerships as in determining the bona fides of other transactions between

family members. *Transactions between persons in a close family group, whether or not involving partnership interests, afford much opportunity for deception and should be subject to close scrutiny.* All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona fides or lack of bona fides of a purported gift or sale.

* * * *

Since legislation is now necessary to make clear the fundamental principle that, where there is a real transfer of ownership, a gift of a family partnership interest is to be respected for tax purposes without regard to the motives which actuated the transfer, it is considered appropriate at the same time to provide specific safeguards—whether or not such safeguards may be inherent in the general rule—against the use of the partnership device to accomplish the deflection of income from the real owner. (Italics supplied.)

It is clear, then, that Congress was merely attempting to insure that a person would not be denied recognition as a member of a family partnership merely because he acquired his interest by a gift from a member of his family, *if, in fact, a real bona fide gift was intended and made.* It is clear, too, that the Congress intended that the courts carefully examine such intra-family gifts to determine *whether a bona fide gift was made, whether the transaction was merely a sham entered into for tax purposes and whether the donor had in fact relinquished dominion and control over*

the interest purportedly transferred. As the Committee Report states—

> All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona fides or lack of bona fides of a purported gift or sale.

Thus, Congress merely was attempting to eliminate from consideration in such cases the one factor that the family partner's purported interest arose through gift if in fact a bona fide gift, was made, and to leave intact the other tests for determining whether a true partnerships existed. Cf. *Commissioner* v. *Culbertson, supra,* p. 742. As we shall show, the Tax Court in considering the instant case gave full effect to these 1951 additions to the Code and, taking into account the expressed intention of Congress, reached a result which is entirely permissible under the Code and one which is clearly supported by the record in the case presented.

2. That the Tax Court gave full consideration to the Code changes made by Congress in the Revenue Act of 1951, as they affected family partnership cases, is evident, we submit, from a reading of its opinion. In great length, the Tax Court examined the 1951 amendments and the accompanying legislative history in order to insure a correct application of the law to the facts presented in the instant case. And, in so doing, the Tax Court recognized that the fundamental principle which Congress intended to establish by the 1951 amendments was that (R. 176)—

> where there is a *real* transfer of ownership, a gift of a family partnership interest is to be respected for tax purposes without regard to the motives which activated the transfer * * *. (Italics supplied.)

Thus, the Tax Court properly addressed itself to the question of whether the evidence established "a real transfer of ownership" or whether the "partnership device" was used merely "to accomplish the deflection of income from the real owner". (R. 176-177.)

The Tax Court did *not* hold that merely because there was a purported gift transfer of partnership interests the children of taxpayer were to be denied recognition as partners. Rather, the Tax Court, as Congress intended, examined the evidence and found "that there were no bona fide gifts of interests in the machines, which were the income-producing assets of the partnership, to the children, and the formation of the Spiesman & Sons partnership was a sham". (R. 182.) Certainly, absent bona fide, or real, gifts of partnership assets, the minor children of the taxpayer could not be considered as being real partners. It is undisputed that they contributed no services whatever to the business. As we have shown, it was not the Congressional purpose that the so-called *Culbertson* test be ignored in family partnership cases, but that Congress merely intended to make clear that the transfer of a partnership interest by gift should not *in itself* invalidate a claimed partnership, if there had, in fact, been a real gift. Thus, in approaching the case first from the point of view of determining whether there were in fact real transfers of interests

in partnership income-producing assets to the taxpayer's minor children and then, after finding that not such transfers had been shown by the evidence, applying the *Culbertson* test, the Tax Court properly exercised the functions and prerogatives granted to it by Congress.

3. Whether bona fide gifts of partnership assets were made to taxpayer's children and whether the parties in good faith intended to join together in the present conduct of a business enterprise are questions of fact which, of course, must be decided in the light of the record in the case. *Commissioner* v. *Culbertson*, *supra*, p. 742. The Tax Court, the trier of fact, found that no bona fide gifts were intended or made and that the taxpayer's children were not bona fide partners in the business during the years 1951 and 1952. Under well-settled principles, such factual determinations may not be disturbed on appeal, unless they are found to be "clearly erroneous". Cf. *Smith* v. *Westover*, 237 F. 2d 201, 203 (C.A. 9th); *Parker* v. *Westover*, 248 F. 2d 490 (C.A. 9th). We submit that the findings of the Tax Court are not only not clearly erroneous but, moreover, are fully supported by the facts of record and, accordingly, the Tax Court's decision should be affirmed by this Court.

Several factors point to the correctness of the Tax Court's findings. First, the partnership agreement, which purportedly transferred ownership of a portion of the partnership assets to the children, was not carried out in the extremely important respect of distribution of profits. As the Tax Court noted (R. 183), although the children purportedly had equal

shares in the business, they did not receive equal treatment with respect to withdrawals from the business. During the years 1952, 1953 and 1954, the amounts witrdrawn for the children were in some instances greater, and in other instances less, than they would have been had the agreement been followed. The explanation offered by taxpayer for this significant departure from the agreement was that (R. 90)—

> the difference in the amount of money withdrawn was due to the fact that Joe, the oldest boy, and Phil, the next oldest boy, had income from dividend stocks prior to the, and more stock, than the other children, and I tried to even up—at that time I tried to even up the cash account of each child, so that if I had an accident, why, or I got killed or died, my youngest child wouldn't say, "Well, my dad wasn't very fond of me; he didn't leave me anything," and I didn't want to have that happen and I wanted them to be even as far as cash was concerned, and then they would eventually receive stock or whatever my dad was going to leave them when he died. But the cash account I tried to even up. It may have been wrong, but at that time I didn't know it.

This, we submit, clearly shows that there was, in fact, no real partnership in which the taxpayer's children were members. On the other hand, this does indicate that what transpired was merely the attempt of a father to provide for his children. As this Court has noted, the law does not require the sanctioning of an obvious device on the part of a taxpayer to build an estate for his children at the ex-

pense of the United States. *Smith* v. *Westover*, 237 F. 2d 201, 203 (C. A. 9th). If, in fact, real gifts of business assets had been made, there could be no reason why each child would not be entitled to the share of the income produced by his assets. Instead, this indicates that no gifts of the assets were, in fact, made and no partnership in any real sense was created.

Similarly, the taxpayer's failure to file any accountings as guardian, until after investigation was initiated by the Internal Revenue Service into partnership affairs, is also an indication that no valid partnership was intended or created. (See R. 100-101.) In addition, the inconclusive nature of the partnership agreement as an instrument of conveyance also is indicative of the fact that no bona fide gifts were made. No claim is made that there was any instrument of conveyance other than the partnership agreement and that document, itself, does not pretend to be such an instrument. Furthermore, as the Tax Court noted (R. 183) the "partnership" did not itself treat the taxpayer's children as having any interest in partnership assets; the partnership returns filed for the period December 1, 1951 to January 1, 1952, and for the year 1952 included the full value of the slot machines (the income-producing assets) in the capital account of the taxpayer and no interest in such machines was included in the capital account of any of his children. Moreover, the interlineations to the partnership agreement, attempting to show that taxpayer's father had an interest in the assets prior to the agreement (R. 165, 170)

itself indicates that there were no real gifts, as claimed, of business assets. And when this evidence is considered together with the obvious tax avoidance motive [4] which resulted in the formation of the alleged partnership it becomes clear, we think, that no real gifts were made and no real partnership was intended.

Moreover, the fact that the taxpayer's children could not legally own interests in the business income-producing assets, the slot machine, also is good support for the Tax Court's finding that they did not acquire any interest in such assets. As noted by the Tax Court (R. 180-181), Idaho law, at the time the partnership was purportedly formed, legalized ownership of such machine only after a license was procured and such machines could not be operated on premises other than those owned by the licensee. Idaho law also provided that no person other than the licensee could have any interest whatever in such machines.[5]

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[4] The alleged partnership was created after the taxpayer's father read a magazine article pointing out possible tax savings through the use of the family partnership device. (See R. 55-56, 74; Ex. 8, R. 58.) The tax avoidance motive may be taken into account in determining the bona fides of the situation. See Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939, Sec. 29.191-1(b)(10), as added by T.D. 6037, 1953-2 Cum. Bull. 213.

[5] Sections 50-1503, 50-1504, 50-1509, Idaho Code (S.L. 1947, c. 151).

The taxpayer apparently misconstrues the opinion of the Tax Court on this point. (See Br. 33-34.) The Tax Court did *not* state that ownership of slot machines was illegal in Idaho during the tax years. The Tax Court pointed out, however, that ownership by the taxpayer's children would

Certainly, it was proper for the Tax Court to infer that the taxpayer did not really intend to transfer any interest in such machines to his children when such a transfer would not ~~per~~ be permissible under Idaho law.

There can be no doubt that on a reading of the entire record, the Tax Court's findings that no real gifts were made and that there was no real partnership formed, but rather that the entire transaction was a sham, are amply supported by the evidence. The Tax Court properly took into account all of the facts—facts existing before, during and after the taxable years—in arriving at its conclusions.[6] These conclusions are certainly not clearly erroneous.[7]

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have been illegal since they were not, and could not have been, licensees.

Moreover, it should be noted that although the Idaho statutes providing for legalized ownership of slot machines was repealed in 1953 (R. 163), it was not until 1954 that additional "capital contributions" were made on behalf of the children to compensate the loss of such assets in the business (R. 91-92). This, too, supports the Tax Court's findings as to lack of bona fides.

[6] The taxpayer, on brief, in effect argues that other inferences, more favorable to his cause, could have been drawn by the Tax Court. It is well settled, however, that it is the Tax Court's function to draw inferences from the facts of record. That other inferences *might* be drawn is immaterial.

[7] The taxpayer suggests that, in any event, the income should be taxed to his father and not to him since some of the gifts were allegedly made by his father. However, it is by no means clear from the record that any of the assets, in fact, had belonged to the father. As pointed out above, the partnership agreement originally described all of the assets

CONCLUSION

For the reasons stated, the Tax Court's decision should be affirmed.

Respectfully submitted,

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as belonging to the taxpayer. (R. 165.) It was only after the Internal Revenue Service's investigation began (R. 170) that the father's name was inserted as being an owner of a share of the assets. Moreover, the business income was derived from the machines placed in a club, opened by taxpayer, in 1944. The machines originally were taxpayer's and he entered into an agreement with the club for a percentage of the receipts from the machines. No agreements were ever executed with the Spiesman and Spiesman partnership nor the Spiesman & Sons partnership. (R. 105-110.) There is no indication that the arrangement would continue without taxpayer's participation. In the circumstances, it is therefore proper to allocate all of the income from the machines to taxpayer.

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